



MONITORING of the administrative barriers to the development of small business in Russia

ROUND 6

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Summary of the key results from the six monitoring rounds.

The Center for Economic and Financial Research (CEFIR) in Moscow with the financial support of USAID is monitoring the level of the regulatory burden imposed by the government agencies on small businesses. The purpose is to evaluate the progress of the deregulation reform, started by the Russian federal government in 2001. The reform includes a number of laws, which significantly simplify the procedures and reduce the administrative regulations on licensing, certification, registration and different inspections.

At present, the results of the first six rounds, conducted in the spring and fall of 2002, the spring of 2003, 2004 and 2005 as well as the fall of 2006, are available. The first round of the survey collected the initial information on the basis of 2001 before any of the deregulation laws came in force. The data from the second and third rounds allows to evaluate the reform progress after the enactment of the new laws on inspections and licensing. The data from the third round helps to assess the effects of the new law on registration. The further improvements in these areas are evaluated with the help of the data, collected during the fourth, fifth and sixth rounds.

The main result of the first round was that in 2001, the situation in all spheres of the federal regulation fell far short of the goals, declared in the new laws. During the first round, the data on the initial levels of the administrative burdens in the areas of registration, licensing, certification and the inspections were collected before the federal deregulation program had been started. The following monitoring stages (rounds 2-6) helped to evaluate the changes from the point of view of scope of the administrative barriers'.

The second round revealed that in 2002, there were significant improvements in the areas of inspections and licensing, which for the most part were sustained in the third round. The third round indicated that the introduction of the law on registration had both a positive and a negative impact on the accomplishment of this procedure, while the new simplified tax system for the small business has stimulated firms to adopt this system in 2003.

The fourth, fifth and sixth rounds demonstrated a further decrease in most of the administrative barriers for the development and creation of the small business, in particular a further simplification in the procedure of registration, lower frequency of inspections and a lower number of illegitimate licenses. Moreover, in each consecutive round (rounds 2 to 5), the respondents believed that the level of fair competition is more important than in the preceding one. This means a rising interest of the business representatives in "proper" problems. In the fifth and sixth rounds, the respondents called the competition a more serious problem than the tax levels, which were leading in the first four rounds.

At the same time, the answers to the questions of qualitative character show that many principles, provided in the laws, are still violated. The registration takes more time than the allowed five days; the firms are required to obtain unnecessary permissive documents, while the inspections occur more frequently and with the violation of law.

Registration

After the introduction of the new law on registration in 2002, the procedure became simpler and faster but more expensive, as was shown in the third monitoring round, conducted after the reform began. However, the consecutive rounds demonstrated a substantial decrease in both the registration duration and its costs. The procedure took less time because the firms stopped visiting the local administration and registration chambers, which used to take up the bulk of their time. Instead, the greater part of the registration procedure was relocated to the divisions of the Ministry of Taxation, where firms spent more time on average than before. The results from the sixth round, however, show that together with the decrease in the number of visited federal agencies, there was an increase in the time and the financial costs of the registration.

Licensing

The results from the six monitoring rounds show that there were significant improvements in the sphere of licensing. After the adoption of the new law in February 2002, the percentage of the enterprises, which applied for licenses and permits, decreased by a third. The process of

obtaining licenses became simpler and less time-consuming in the first half of 2002 but in the second half, the costs of obtaining permits returned to the former levels and the situation did not change a lot in the consecutive rounds. An average financial fee of obtaining a license was higher by two times than the fee, provided in the law. In the fifth round, the number of legitimate licenses exceeded one half of all permissive documents for the first time. Yet, about half of the licenses and permits issued were issued for types of activities that are formally not subject to licensing. The results of the 6th round show that this situation remained the same in 2006.

Inspections

The new law on inspections came in force in August 2001. Prior to the law introduction, many small firms were subjected to frequent visits by the inspecting agencies. With the introduction of the new law, the number of visits by the government agencies decreased significantly. Correspondingly, the amount of time, spent on inspections by the management of small firms, and the involved financial costs diminished. However, the results of the second and the third rounds indicated that in 2002, the substantial abuses by the inspecting agencies continued: many firms were subjected to several planned inspections by a single agency, which is a direct violation of the new law. In 2003 and 2004, the frequency of inspections by the agencies declined. Nonetheless, the businesses reported frequent unplanned inspections, carried out without a warrant. Furthermore, the decrease in the financial costs, noted in the third and fourth rounds, was later replaced by an increase both in the number of firms, which suffered financial losses and a number of firms, which were “fined” by unofficial rates. The fifth round revealed an increase in the number of firms, which were pressed to give bribes. In the sixth round, the inspections’ frequency by different agencies stayed on the level of the fifth round; the amount of the financial losses did not differ from the fifth round. At the same time, the prevalence of the firms’ financial losses from the inspections decreased for most types of the inspecting agencies.

A simplified tax system for small firms

The monitoring results show that a simplified tax system for small businesses does improve the tax administration. In such a way, the firms, which switched to the simplified system (this process was popular in 2003, when the new law was passed), pay lower number of taxes, spend less time on its administration and, in general, see the tax system as a lesser evil than the firms, which follow the standard procedures.

Land and premises

The procedure of buying/leasing land/premise is problematic for the small business. The surveys show that some firms can get such procedures over very quickly (in 2-3 months) or this process takes more than a year. In this way, as the of the six round data show, in 2006, around 80% firms that bought the premises from the government spent , on average, around 1.5 months on the procedure. The rest 20% of the firms, involved in these transactions, did not finish the paper work by the time the survey took place and by the moment of the survey spent around six months on the procedure. Among procedures, buying premises from the government is the most costly, time-consuming and the least transparent one

The overall evaluation

As a whole, the results provide basis for cautious optimism, even though between the second and third rounds, the reforms have slowed down. The subjective estimates of the business climate show that the registered improvements in the first four rounds were not recorded in the fifth, while some of the estimates got substantially worse. The immediate effect of the new laws was positive but the progress has stopped and the level of the administrative burden for small businesses remains high. In general, the results from the sixth round show that while there is a small positive dynamics in some spheres there were no major improvements. The current situation does not corresponds to the norms, provided in the legislation. In such a way, the government has a great deal to do in order to provide a real enforcement of the new laws.

The results from the 6th round: a detailed description

There is a more detailed presentation of the results from the 6th monitoring round in the CEFIR presentation, which can be found on <http://www.cefir.ru>.

Registration

The results from the 6th monitoring round showed that a median firm spent fewer efforts on the registration procedure and the number of visited federal agencies for registration decreased. However, there was an increase in waiting time for receiving the registration documents from the federal agencies. Nevertheless, there are no noticeable changes from the 5th round, taking into account the size, regional and sectoral characteristics of the firms.

The situation is different across the Russian regions. If in the Altai region, one needs 7 days for registering the business, it takes around a month in St. Petersburg.

Just over half of the firms are registered within the timeframe of five working days, specified by law. For more than 70% of firms, the registration costs top 2,000 rubles, set by the new legislation. As in the previous rounds, both the time and the financial costs are higher if the registration is done with the help of the intermediary.

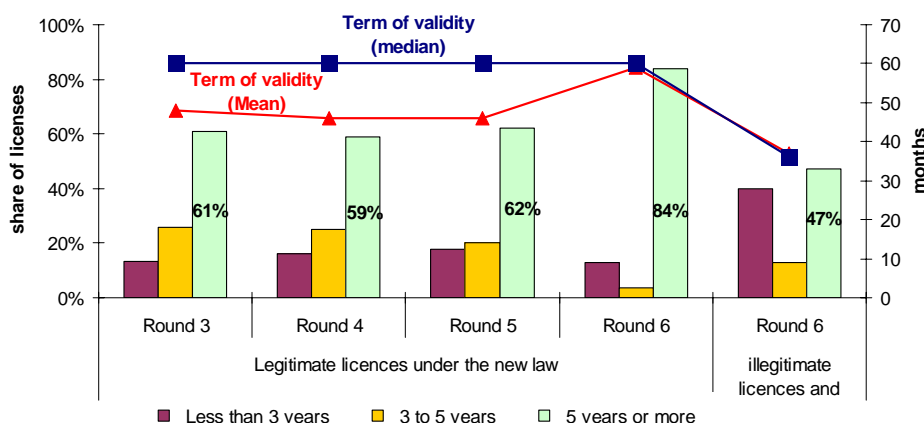
In 2006, there was an increase in the number of firms, who used the personal connections (around 20% of all firms) and making presents (around 12%) during the registration.

Licensing

Figure 1 shows the development of the ratio of the legitimate and illegitimate licenses and permits and their periods of validity. During the first half of 2006, 14% of firms applied for licenses. The same number of firms applied for licenses in the second half of 2004. However, this is much less than the number of firms, which applied for licenses in the first half of 2001, i.e. before the new law on licensing came into force.

At the same time, the waiting time for obtaining the license did not change that much (about a month); there was an increase in the efforts, spent by firms, which amounted to 14 working days.

Figure 1. Licenses: term of validity and legitimacy



As in 2004, the share of the legitimate licenses amounted to 53%. In the first half of 2006, for the first time, the median and the average time of the license validity conforms to the norms, specified in the new law: no less than five years.

It is important to notice, that the term of validity for licenses and

permits, which are not legitimate by new law, is significantly less: on average around three years. Nevertheless, the costs to get such licenses are usually less than to get the legitimate licenses. In 2006, as before, most illegitimate licenses are given out by the local authorities.

Inspections

In the first half of 2006, as compared to the second half of 2004, there was a significant decrease of the total number of inspections of any given firm by all inspecting agencies. Nevertheless, this happened due to the significant decrease of the inspections by the social securities, while the inspections by other agencies did not change that much.

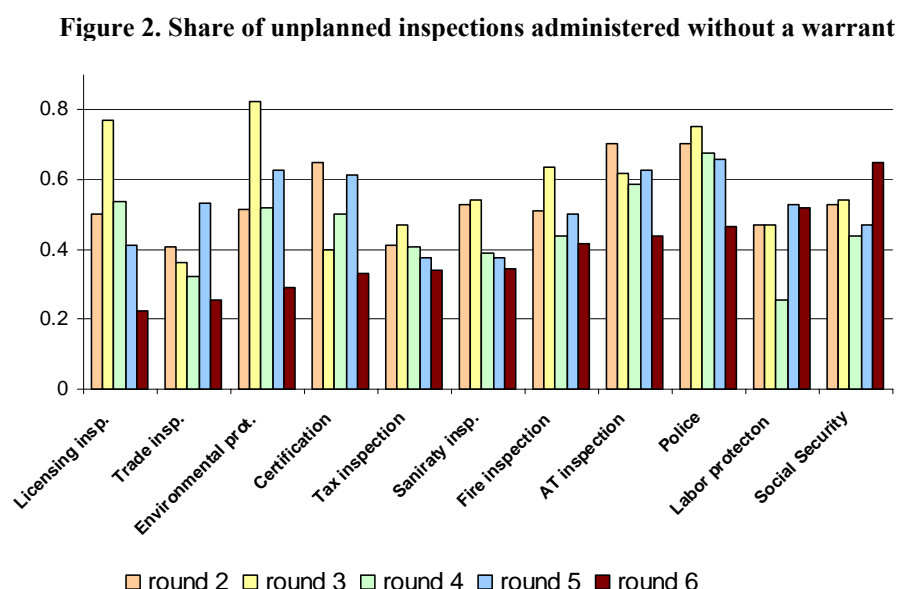
In comparison with the second half of 2002, there was a decrease of inspections by the sanitary agencies, as well as by police, social securities and the administrative-technological authorities.

An average inspections' frequency is different among the regions: from 0.9 in Komi to 5.0 in the Moscow region over a six-month period (the first half of 2006). The regions are diverse in the dynamics of changes in the inspections' frequency.

The majority of the inspecting agencies complies with the norms, provided by the new law and does not visit any particular firm more than once every two years. The exceptions are: the tax, the fire and sanitary authorities, as well as police, which during the 2003-2006 period more than once in two years has visited the 35%, 34%, 21% and 13% of firms, respectively.

As far as the repeated inspections are concerned, the number of firms, which are inspected frequently by different authorities did not change a lot in comparison with the fifth round, except for the police inspections, where there was some decrease in the number of visited firms. The repeated inspections are a frequent phenomenon for a number of authorities: 33% for police and 31% for sanitary authorities for a six-month period. The sixth round indicates that if there were repeated inspections at a firm, than the inspections are conducted 6-43 times more often than needed. This shows that if an inspecting authority is inspecting a firm for the second time, then there would be consecutive inspections in the six-month period.

Figure 2 shows the dynamics of the number of firms, where there were unscheduled



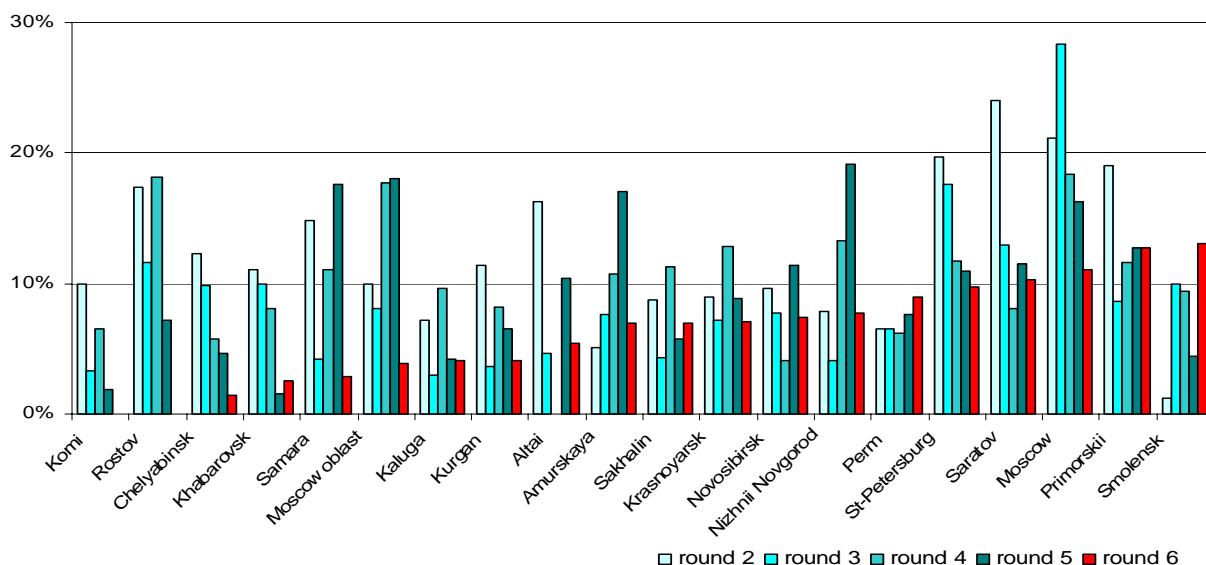
inspections with a violation of the law, namely, without a warrant. Around half of all inspections, conducted by the police and the trade inspections, are unscheduled. Moreover, a significant number of unscheduled inspections (more than half of the inspections by the labor protection and the social securities) are still conducted without a warrant.

An average inspections' duration, depending on the authorities, takes between 5.2 days (tax authorities) and 1.2 days (police, trade inspections). In comparison with 2004, there was an increase in the financial losses during the inspections by the licensing authorities, while the financial losses decreased during the inspections by labor protection, trade and tax inspections. At the same time, there was an increase in the illegal penalties during the inspections by the tax authorities, while they decreased during the inspections by the fire authorities.

By the entrepreneurs' subjective evaluations, the inspection costs constantly grow, even though the objective data shows otherwise. During the 6th round, there was an increase in the amount of complaints about the costs' increase, connected with inspections by police, sanitary and fire authorities. At the same time, there is no unified opinion by the directors of the small businesses about the transparency of the inspections' rules: around 30% believe that the rules are more or less transparent, while around the same number believe otherwise.

Figure 3 shows the dynamics of the number of firms, which are pressurized to give bribes during the inspections in different Russian regions. Between 0% and 13% of the small businesses in different regions answered positively to the question about the pressure from the authorities in order to get a bribe. At the same time, none of the firms in the Komi Republic, Cheliabinsk and Samara oblasts faced this problem, which is a significant improvement in comparison with 2004.

Figure 3. Share of firms feeling pressed to give bribes during inspections



At the same time, the situation has worsened in the Smolensk oblast.

The tax system

The practice of using the simplified tax system stays stable. Out of all firms, who could have used the simplified tax system, around 66% of firms used it in 2006. The main reasons why other firms do not switch to it are the following: “the regular system is easier and more understandable” (46% of firms) and “partners do not use the simplified system (this creates problems with VAT)” (34% of all firms).

A number of firms, which used the simplified tax system, stopped using it after some time. The majority of the firms reject to use the simplified system because they “outgrow” the limits (49% in the 6th round). The main reasons for withdrawal among the firms, who stopped using the simplified tax system and who have a right to use it, are: “the regular system is easier and more understandable” (22%) and “partners do not use the simplified system” (17%).

Leasing and purchasing land and premises

The purchase of premises from the government is the most costly from the point of view of finance and the time. There is a big amount of pressure from the authorities during the procedure and it is the least transparent. During the sixth round, the dynamics of changes in the administrative burden of these procedures is ambiguous. On one hand, there is a decrease in the corruption and an increase in the transparency of the procedures, while on the other, there is a growing necessity to visit the federal authorities, a growing number of agencies to visit, meaning that there is growing time costs of the procedures.

The subjective evaluations of the entrepreneurial climate and the federal regulation.

The subjective business evaluations, regarding the entrepreneurial climate, in general continue the positive dynamics. Table 1 provides the average estimates of the severity of some of the problems for the small business. One of the main business problems is the fair competition: in the 6th round, it, for the first time, took the second place after the frequent changes in law.

Таблица 1. Общая оценка предпринимательского климата

	2001 - II	2004-II	2006-I
Frequent changes in laws		2.99	2.79**
Fair competition	2.62	2.86 **	2.73**

Tax level	3.52	2.78	2.65**
Macro instability	3.28	2.89 **	2.54**
Anticompetitive barriers	2.26	2.3 **	2.39
Regulation	2.90	2.45	2.35**
Tax administration	3.10	2.59	2.34**
Corruption	2.10	2.03 **	2.26**
Difficulties with access to capital	2.63	2.42 *	2.25**
Racket	1.34	1.21	1.19

5 – threatens the existence of the firm, 4- a very serious problem, 3 –a serious problem, 2 – a slight problem, 1 – not a problem

Stars indicate significant changes from previous round at 5% (*) and 1% (**) level of significance in panel regressions with fixed effects.

The tax levels, the tax administration, the federal regulation and capital formation, on average, became less significant problems for the small business. There is also a negative tendencies during round 6: there are a problem of unequal competition and corruption.

Only two problems, connected with the federal regulation, became severer: inspections in general and inspections by the tax authorities. At the same time, the severity of the problems, connected with the other spheres of the federal regulation, significantly decreased.

Conclusions

Summarizing the results from the sixth round, one needs to look at the following improvements:

- Average length of license validity significantly increased and almost reached the deregulation target
 - 84% of firms have licenses valid for over 5 years
- The majority of inspecting agencies decreased the number of unplanned inspections without warrants
- The total number of inspections decreased, primarily because of a decrease in the number of inspections by social insurance agency
- There has been a significant decrease in the incidents of bribe pressure on the part of bureaucrats during purchase and lease of land; transparency of both procedures increased
- For the first time fair competition has become a more serious problem than economic instability for business
 - it became the second most important problem after frequent changes in the legislation

At the same time, there was also some deterioration in the federal regulation:

- An increase in use of personal connections during registration
 - About 20% of firms use personal connections during registration
- An increase in the share of inspections by licensing authorities that lead to financial losses for firms
- According to perceptions of firm managers, inspections and, particularly, tax inspections have become a more serious problem for business compared to 2004
- According to perceptions of firm managers, there has been a significant worsening of corruption and unfair competition

On overall, we evaluate the results of deregulation reform in the first half of 2006 as mildly optimistic – there has been a number of positive developments in the sixth round compared to fifth round and overall trends towards deregulation slowly continues. Yet, along a number of dimensions, the enforcement of deregulation reform has not reached targets set by the new legislation. There are also a few worrisome tendencies: in particular, an increase in subjective perception of problems associated with corruption and unfair rules of the game for SME growth and development